DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0102
Corporate Income Tax
For the Years 1996-1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Corporate Income Tax- Unitary Relationship

Authority: IC 6-8.1-5-1 (b) *Container Corporation of America v. Franchise Tax Board.,* 463 U.S. 159,103 S.Ct. 293 (1983).; *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768, 112 S.Ct. 2251 (1992), *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982).

The taxpayer protests the department's determination that it is not a unitary business.

II. Corporate Income Tax- Business Income

Authority: IC 6-8.1-5-1 (b), 45 IAC 3.1-1-153, *Hunt Corporation v. Indiana Dept. of State Revenue*, 709 N.E.2d 766 (Ind. Tax Ct. 1999).

The taxpayer protests the department's determination that its partnership distributive income is not business income.

III. Corporate Income Tax-Net Operating Loss Carryback and Carryforward

Authority: IC 6-3-2-2.

The taxpayer protests the department's disallowance of net operating loss carryback and carryforward.

STATEMENT OF FACTS

The Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax, interest, and penalty for the tax years ending June 30, 1996 through June 30, 1999 on three related corporations. To identify the taxpayers in the three cases, they have been denoted"taxpayer 1, taxpayer 2, and taxpayer 3." The taxpayer at issue here is taxpayer 1. The three related taxpayers formed two partnerships which own and operate two corporations providing ambulance services in Indiana, "ambulance 1 and ambulance 2."

A Delaware corporation which provides ambulance and fire services throughout the nation is the parent corporation of the consolidated group including the three taxpayers and the Indiana ambulance service corporations. Taxpayer 1 is a limited partner in the partnership owning and operating ambulance 1. Taxpayer 2 is the general partner in the partnership between taxpayer 1 and taxpayer 2 which owns and operates ambulance 1. Taxpayer 2 is also the general partner and taxpayer 3 is the limited partner in the partnership which owns and operates ambulance 2. This partnership including taxpayer 1 as a limited partner was formed on December 25, 1995 and the taxpayer became a 99% limited partner as outlined in the partnership agreement with the contribution of cash and property. Prior to the formation of the partnership, the taxpayer was operating the ambulance operation and reporting its gross receipts as a regular "C" corporation. The department has reduced the amount of partnership income distributed to the taxpayer as this amount was reduced for federal tax purposes, which results in a refund to the taxpayer. However, the department has also reclassified the distributions from the ambulance partnership to the taxpayer as nonbusiness income or loss because the department asserts that the taxpayer does not maintain a unitary relationship with the ambulance partnership. As a result, the department will not allow the taxpayer to utilize its losses as NOL deductions in past or future years. The taxpayer filed NOL carryback refund claims to utilize the NOL generated in the year ended June 30, 1997. The department has denied these refund claims due to its reclassification of the distributions. The taxpayer protested this reclassification and denial of refund on three grounds. First the taxpayer claims that it is a unitary relationship. Secondly, the taxpayer contends that even if it is not considered a unitary relationship, the income is business income. Finally, the taxpayer argues that non business income net operating losses can be carried back and forward. A hearing was held and this Letter of Findings results.

I. Corporate Income Tax- Unitary Relationship

Discussion

Pursuant to IC 6-8.1-5-1 (b) all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect.

The taxpayer protests the department's determination that the taxpayer does not maintain a unitary relationship with the related corporations. The determination of whether or not a unitary relationship exists in a partnership of corporations depends on 45 IAC 3.1-1-153(b) as follows:

> If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula. . .

Therefore, in order to be considered a unitary operation, the taxpayer must demonstrate that the relationship between itself and the partnership meet the established standards of a unitary relationship.

The Supreme Court has considered the issue of a unitary relationship in several cases and with several analyses. The one essential characteristic in each of the cases is day-to-day operational control.. *Container Corporation of America v. Franchise Tax Board.,* 463 U.S. 159,103 S.Ct. 293 (1983).; *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768, 112 S.Ct. 2251

(1992), *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982). To establish that the taxpayer has a unitary relationship with the partnership, the taxpayer must establish that it has operational control of the partnerships or that management of the partnerships is centralized with the taxpayer.

The taxpayer argues that it qualifies as a unitary relationship because it has officers and directors in common with the other corporation in the partnership, the consolidated group of companies has an Operations Manager who is responsible for the Indiana operations, there are monthly meetings of regional presidents, the corporations in the consolidated group use economies of scale in purchasing insurance and servicing of debt, and functional integration by centralized accounting and human resource benefits. These do not, however, indicate that the taxpayer has operational control of the day-to-day operations of the partnership as required by the Supreme Court.

Rather, the taxpayer is the limited partner and the other corporation is the general partner in a limited partnership. Taxpayer's argument ignores the general legal principal that a limited partnership is one in which the general partners control the business. Limited partners such as the taxpayer "contribute capital and share profits but who cannot manage the business and are liable only for the amount of their contribution." *Black's Law Dictionary,* p. 1142 (7th ed. 1999).

Along with general legal principals, the partnership agreement submitted by the taxpayer contradicts the taxpayer's arguments. Item 6 of the partnership agreement states as follows:

> The General Partner shall have the full, exclusive and complete power to manage and control the business and affairs of the Partnership, all of the rights and powers provided to general partnerships under the laws of the State of Delaware, as well as any other rights and powers necessary to accomplish the purpose of this

Thus, the contract establishing the relationship of the entities indicates that general partner completely controls the actions and policies of the taxpayer. Since all authority and control is invested in the general partner, the business relationship cannot be unitary.

Finding

The taxpayer's protest is denied.

II. Corporate Income Tax- Business Income

Discussion

The department did not consider the taxpayer's derivative income from the partnership business income. The taxpayer argues that even if the taxpayers and the Indiana partnerships are not unitary in nature, the separately allocated partnership loss is still business income or loss, just from a different trade or business than that of the corporate partner. The taxpayer bases this argument on 45 IAC 3.1-1-153 as follows:

> . . . (c)If the corporate partner's activities and the partnership's activities do not constitute a unitary business. . . the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:
>
> > (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three factor formula. . .
> > (2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.
>
> . . . (e)After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

Reading these regulations together, the taxpayer argues that in Indiana a business conglomerate can be considered not a unitary concern and still have business income. The taxpayer reads these regulations and infers from the phrase "added to the corporate partner's other business income" (emphasis added) to mean that the partnership's distributive income is automatically considered business income. The taxpayer errs in this conclusion.

The Indiana Tax Court addressed this issue in *Hunt Corporation v. Indiana Dept. of State Revenue*, 709 N.E.2d 766 (Ind. Tax Ct. 1999). In *Hunt* the Court determined that a corporate partner's income from a corporate partnership should be determined by apportionment of that income at the corporate partner level when the corporate partner and the corporate partnership have a unitary relationship. The Court stated at page 776 as follows:

> If the income from the partnerships constitutes business income (i.e., if the affiliated group and the partnerships are engaged in a unitary business;, under section 6-3-2-2, all of that income would be subject to apportionment based on an application of the affiliated group's property, payroll, and sales factors. If the income from the partnerships constitutes non-business income for the affiliated group (i.e., if the affiliated group and the partnerships are not engaged in a unitary business), that income would be allocated to a particular jurisdiction.

The Court's reasoning is clear. All of a corporate partner's income from a corporate partnership that has a unitary relationship with that partner is business income; all of a corporate partner's income from a partnership with a non-unitary relationship is non-business income. In this case, it has been determined that the corporate partners in the corporate partnership do not have a unitary relationship. Therefore the income of the individual corporate partners is not business income.

Finding

The taxpayer's protest is denied.

III. Corporate Income Tax-Net Operating Loss Carryback and Carryforward

Discussion

Alternatively, the taxpayer contends that nonbusiness income or loss which is allocated to Indiana can be carried back and forward as a net operating loss in Indiana pursuant to IC 6-3-2-2.6 as follows:

> . . . the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred.

"Section 2 of this chapter" refers to IC 6-3-2-2, which defines "adjusted gross income derived from sources within Indiana." Section 2 provides Indiana's general rules for attribution of income among states, whether the income is business or nonbusiness income. The last paragraph of IC 6-3-2-2 provides "In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources Indiana. Therefore it is clear that a nonbusiness loss allocated to Indiana is included in the computation of the net operating loss carried to another year.

Finding

The taxpayer's protest is sustained.

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